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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 171

FEDERATED DEPARTMENT STORES, INC.,

Appellant,

–v.–

LAWRENCE E. GEROSA, as Comptroller of The City of New York,

Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

MOTION TO DISMISS OR AFFIRM

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 71

FEDERATED DEPARTMENT STORES, INC.,

Appellant,

—v.—

LAWRENCE E. GEROSA, as Comptroller of The City of New York,

Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

MOTION TO DISMISS OR AFFIRM

Appellee in the above-entitled case, pursuant to a request of the Court transmitted by its Clerk, moves to dismiss or affirm the appeal on the ground that the questions presented are so insubstantial as not to need further argument.

Statement

This is an appeal from a final order of the Court of Appeals of the State of New York, dated December 30, 1965, affirming an order of the Appellate Division of the Supreme Court of that State.

The order upheld a tax deficiency assessed under the general business portion of the former New York City General Business and Financial Tax, a gross receipts tax for the privilege of doing business. The assessments were for the privilege periods from July 1, 1953, to June 30, 1959, measured by receipts for the calendar years 1953 through 1958, and are in the total amount of $55,210.50, inclusive of interest and penalty.

The issues raised relate solely to the validity of an allocation formula applied to interstate sales made by the New York City stores of the appellant.

Facts

(1)

The appellant is a Delaware corporation (R. 66-67). Its principal office is in Cincinnati, Ohio (R. 67). During the years in question it operated 42 retail department stores and specialty stores in eleven states (R. 68).

The appellant's New York City stores consisted of the Abraham & Straus store in Brooklyn and the Bloomingdale's stores in Manhattan and Queens (R. 68, 70). The Abraham & Straus division also operated three stores in the New York counties of Nassau and Suffolk (R. 68-69). The Bloomingdale's division also operated a store in New Rochelle, New York and one in Stamford, Connecticut (fols. 209-210).

The appellant's other stores were in Wisconsin, New Mexico, Texas, California, Massachusetts, Maine, Oklahoma, Ohio and Florida (City's Exhs. J-O, not printed).

(2)

The interstate sales involved in the present case were made by Bloomingdale's in Manhattan and by Abraham & Straus in Brooklyn. They normally were made to customers from New Jersey and Connecticut (R. 170, 182). The sales arose in one of three ways: the customer came into the New York City store to place the order, or the customer either mailed or telephoned the order to the store (*ibid.*).

Shipments of the articles ordered were by parcel post, United Parcel Service or express (R. 170). Payments were made through charge or credit accounts; by check, money order or cash; or by C.O.D. (R. 171). All moneys collected were remitted to the New York City stores (*ibid.*).

There was no participation in these sales by any out-of-State office of the appellant except its main office (R. 170-171). The main office in Cincinnati, Ohio, participated in the operation of the New York City stores, as well as in that of the other stores, by making policy decisions (R. 171-172). It provided advisory services in such fields as forecast of economic conditions, store organization and executive personnel, financial policies, taxes, insurance, etc. (R. 67). It also conducted special research studies on such matters as consumer credit selling, market analysis, store operations and methods of enhancing volume and profit (R. 68).

(3)

During the years in question the appellant's sales made at out-of-City stores ranged from $327,663,478 to $466,287,764 and constituted from about 70% to about 73% of its total receipts (Resp. Exh. D, R. 303). These

sales were treated as non-taxable and are not included in the tax base.

For the same years appellant's New York City stores made purely local sales ranging from $131,555,992 to $163,868,568, which constituted about 26% to 28% of its total sales (*ibid.*). These sales were treated as wholly taxable and the entire receipts from them are included in the tax base.

In these years the New York City stores' sales involving delivery to customers in other States ranged from $5,871,271 to $7,441,711 (*ibid.*). They constituted from 1.06% to 1.42% of the total receipts. New York City does not include all of these receipts in its tax base. It treats them as allocable receipts and applies its allocation formula to determine what portion of these receipts should be included in the tax base. The only issues in the case relate to the formula used for this purpose.

(4)

At the hearing appellant asserted and on appeal it has argued that a so-called Massachusetts three factor formula should have been used to determine the portion of the allocable receipts to be included in the tax base. Even the use of such a formula would have resulted in a substantial tax deficiency, approximately half of the deficiency found. On its tax returns the appellant, for all the years in question, treated only $3,487,852 of its allocable receipts as includable in the tax base (R. 35). The use of the Massachusetts formula as sought by appellant would have raised this amount to $10,375,917 (see amounts under Method 2 of Pet. Exhs. 46 and 47, R. 292). The City's formula raised this to $18,361,192 (R. 35). Thus, even the adoption of the Massachusetts formula for the allocable receipts would have resulted in a deficiency of principal of tax of approximately $17,000 for the years in question.

ARGUMENT

The claim that the New York City Comptroller's allocation formula violates the Commerce Clause, the Equal Protection Clause and the Due Process Clause of the United States Constitution does not present a substantial federal question.

The jurisdictional statement repeats arguments which are essentially the same with respect to each of the constitutional issues raised. To avoid repetition we shall deal with all of them under this single heading.

(1)

The appellant does not challenge the right of the City to include an allocated portion of the interstate receipts in the measure of the tax. It confines its attack to the allocation formula used to determine how much of such receipts should be attributed to New York City.

Moreover, the appellant does not have any sound basis for claiming that the portion of the receipts from interstate sales by its New York City stores attributed to that city is excessive. Nothing in the record even suggests that any store in any other State aids or contributes to the interstate sales here involved. No out-of-State office participated in these sales. Nor, aside from the fact that Bloomingdale's has a store in Stamford, Connecticut, and that all stores have executive and advisory services performed by the principal office in Ohio, is there any evidence that any other store, property or employee of the petitioner in any way contributes to the operation of any aspect of the petitioner's New York City stores or aids these local stores in obtaining their receipts or making their sales.

It is true that the appellant's assistant tax manager (referred to by appellant as its "expert") testified that it was not possible to attribute the earning of any particular type of receipt to any specified portion of its property or wages, but he never suggested in what way the property or wages of appellant's out-of-State stores did or could have contributed to the interstate sales made by the New York City stores.

Despite the extremely limited extent to which property, wages and activities of the appellant outside New York contributed to the production of the interstate receipts of the New York City stores, the City's allocation formula attributed only from about 45% to about 48% of these receipts to the New York City tax base for the various years in issue. It is, thus, plain that there is no basis for asserting that the formula has attributed to New York City more than a fair share of these receipts.

If a special formula were devised to deal with the actualities of the present case, the property and wages of the stores outside New York City would be completely disregarded since they in no way contribute to and have no relation to the receipts of the New York City stores. The only property and wages outside New York which would be considered would be that portion of the wages and the property of the principal office in Ohio which could be deemed attributable to the New York City stores and, possibly, a portion of the property and wages of Bloomingdale's Stamford, Connecticut, store. Such a formula would, in all probability, result in a percentage, not of 45% to 48%, but in excess of 90% to be attributed to New York City.

(2)

There is no merit to the suggestion that the City's formula is invalid simply because it is unique or because it is a two factor formula.

For many years allocation formulas have been used in applying property taxes, income taxes and franchise taxes to businesses that operate across State lines. These formulas have varied from the simple single factor mileage formula to complex multi-factor formulas.

For example, in imposing property taxes or taxes in lieu of property taxes, the percentage resulting from the single factor of mileage within the taxing state over total mileage has been applied to the property of transportation companies, usually after first deducting the separable localized property. *Nashville, C. & St. L. Ry.* v. *Browning,* 310 U. S. 362 (1940); *Ott* v. *Mississippi Barge Line,* 336 U. S. 169 (1949); *Railway Express Agency* v. *Virginia,* 358 U. S. 434 (1959). Similarly, franchise taxes on railroads have applied a mileage factor to the total gross receipts. *Maine* v. *Grand Trunk R'y Co.,* 142 U. S. 217 (1891).

Franchise taxes on capital stock have used a single factor formula of property and assets in the taxing state to all property and assets. *International Shoe Co.* v. *Shartel,* 279 U. S. 429 (1929). Another franchise tax was applied to capital stock, surplus and undivided profits plus long term obligations after using the single factor of gross receipts in the taxing state to all gross receipts. *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331 (1939). One franchise tax used a two-factor formula of property and business done. *Hump Hairpin Co.* v. *Emmerson,* 258 U. S. 290 (1922); *Western Cartridge Co.* v. *Emmerson,* 281 U. S. 511 (1930). Under another franchise tax the capital stock was divided in half and a property factor was used for one-half while a business done factor was applied to the other half. *International Harvester Co.* v. *Evatt,* 329 U. S. 416 (1947).

Franchise taxes measured by net income and net income taxes frequently use the so-called Massachusetts formula.

This formula employs the three factors of property, payroll and receipts. *Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942). Other net income taxes substitute a manufacturing cost factor for the payroll factor or use only two of these factors or use the sole factor of sales receipts. See ALTMAN AND KEESLING, *Allocation of Income in State Taxation* (1946), pp. 129 *et seq.**

The aim of an allocation formula was well stated in *Ott* v. *Mississippi Barge Line,* 336 U. S. 169 (1949), where the Court said (p. 174):

> "The problem under the Commerce Clause is to determine 'what portion of an interstate organism may appropriately be attributed to each of the various states in which it functions.' *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, 365."

The nature of an allocation formula, however, is such that it cannot achieve precise results. In *Illinois Central R. Co.* v. *Minnesota,* 309 U. S. 157 (1940), the Court said (p. 161):

> "That the apportionment may not result in mathematical exactitude is certainly not a constitutional defect. Rough approximation rather than precision is, as a practical matter, the norm in any such tax system."

As a result, formulas have been upheld even where, unlike the formula here involved, they superficially appear to create unfair results. Thus, in cases involving franchise taxes measured by net income, the courts have upheld

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* "There is a tremendous diversity in types of formulas used. Indeed, no two taxing units use formulas that are alike in all respects. Different factors are used in the formulas; or else, when the same factors are employed, they are defined differently." MORSS, *Apportioning Corporate Income Among States for Tax Purposes,* 42 Taxes, No. 4, p. 261 (April, 1964).

formulas which attribute a portion of the net income to a State despite the fact that the evidence shows that the business actually done in that State resulted in a loss. *Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942); *Bass, Ratcliff & Gretton* v. *State Tax Comm.,* 266 U. S. 271 (1924).

In *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331 (1939), an allocation formula using the single factor of gross receipts was employed as a measure of the share attributable to Texas in imposing a corporate franchise tax measured by the outstanding capital stock, surplus and undistributed profit of the corporation, plus its long term obligations. The formula was upheld despite the fact that the capital it allocated to Texas exceeded $23,000,000, while the value of all assets located in Texas was somewhat over $3,000,000 (308 U. S. at p. 334).

Only when there is "clear and cogent evidence" that the formula is attributing extraterritorial values to the taxing State will it be upset. *Hans Rees' Sons* v. *No. Carolina,* 283 U. S. 123 (1931). *Butler Bros.* v. *McColgan,* 315 U. S. 501, 507 (1942); *Railway Express Agency* v. *Virginia,* 358 U. S. 434, 444 (1959).

(3)

There is one major difference between the formulas we have just been discussing and an allocation formula to be used in imposing a privilege tax measured by gross receipts. Under a property tax, a franchise tax or a net income tax, the percentage arrived at by the allocation formula is normally applied to all of the property, all of the capital stock, all of the assets or all of the net income. Sometimes, usually under property taxes, purely local

elements are treated separately, but the percentage shown by the formula is applied to all the remaining property.

If a similar practice could be followed in imposing a tax measured by gross receipts, the adoption of an appropriate allocation formula would be comparatively simple. Any of a number of the commonly used formulas, including the three factor Massachusetts formula, could be used. Where a tax is measured by gross receipts, however, it seems dubious whether a company which operates in more than one State can be taxed by applying an allocation formula percentage to all of its gross receipts without regard to where or how they are derived. For example, if the allocation under such a formula resulted in taxing a portion of the total receipts which exceeded all of the New York City receipts, it would hardly seem proper for New York City to measure its tax in part by a portion of the petitioner's receipts from its Texas, California and other stores when there is nothing in this City or State which in any way relates to those receipts other than the fact that all of the stores are owned by a single corporation.

It would seem more fitting, if not imperative, that the New York City tax be measured solely by receipts of the New York City stores. In so limiting the measure of the tax no problem arises with respect to the receipts from the local stores' intrastate sales. All of these receipts are properly included in the tax base. The difficulty arises in determining how much of the local stores' receipts from sales it makes across State lines should be attributed to New York City and included in the tax base. This requires the use of an allocation formula.

The aim of the formula, however, differs from that of the formulas used for other taxes. Those formulas are designed to determine what share of the *entire* income, etc.

of a company is attributable to a particular taxing State. Under a tax measured by gross receipts the formula seeks to determine what share of a *portion* of the gross receipts is attributable to a particular taxing jurisdiction. The portion to which the formula is applied is that which comes from interstate sales or activities. It does not include all the interstate receipts; it includes only the interstate receipts directly related to that taxing jurisdiction.

In the present case we are not dealing with the allocation of *all* the interstate receipts of the petitioner. Receipts from interstate sales by petitioner's stores located outside New York City are not included in the measure of the tax. This being so, the sole issue is the extent to which the receipts of New York City stores from sales involving delivery to customers in other States are to be attributed to New York City.

The formula actually used was designed to cover many and varied circumstances. As a result, it treats a portion of all of petitioner's property and wages, including those of all of its stores, as contributing to the New York City interstate receipts. The net result of this is beneficial to the petitioner because it reduces the percentage of the receipts attributed to New York City.

(4)

We turn now to the actual New York City formula.* It is basically a two factor formula, using the factor of real and tangible personal property and the factor of wages and salaries. The element of receipts is used in the formula, but it is used merely to determine how much of

* The formula, as promulgated, is to be found at pp. 25 *et seq.* of the Record.

the wages and salary and how much of the property, within and without the City, should be deemed to have contributed to the New York City interstate receipts.

In the formula the New York City interstate receipts are referred to as allocable receipts; the New York City intrastate receipts are designated as wholly taxable receipts; and the receipts which have no direct relationship to New York City are termed non-taxable receipts.

The first step under the formula involves a determination of how much of the property of the taxpayer is deemed to have contributed to the creation of the New York City interstate receipts, that is, the allocable receipts; how much of this property is within and how much without the City; and the percentage that the portion within the City constitutes of all the property which contributed to creating these receipts.

The formula does not treat all of the New York City property as contributing to the creation of the allocable receipts. It regards the local property as having contributed to creating the intrastate or wholly taxable receipts as well as the allocable receipts. To determine how much of the New York City property shall be assigned to the allocable receipts, the value of all of this property is multiplied by a fraction. This fraction has as its numerator the allocable receipts and has as its denominator all of the New York City receipts (the allocable receipts plus the wholly taxable receipts). The result of this computation becomes the numerator of the property factor.

The denominator of the property factor is arrived at in a similar manner. The property outside New York City is multiplied by a fraction which has as its numerator the New York City allocable receipts and has as its denominator the same allocable receipts plus all of the non-taxable

receipts. The resulting figure is the portion of the out-of-City property deemed to have contributed to creating the allocable receipts. To this figure is added the property in New York City which also has been deemed to have contributed to creating those allocable receipts. The total is all of the property, in and out of the City, which is regarded as having created the allocable receipts. This total becomes the denominator of the property factor.

The ultimate fraction which results shows the ratio of the property in New York City devoted to creating the allocable receipts to all property devoted to creating such receipts.

This ratio or fraction, expressed as a percentage, is the property factor. It is designed to show what percentage of all of the property deemed to have contributed to the creation of the allocable receipts is property in New York City.

The wages and salary factor is established in precisely the same manner except that wages and salaries are used in place of property.

When both of the factors are established, the two percentages thus reached are added and then divided by two. The allocable receipts are multiplied by this final percentage to determine how much of the allocable receipts should be placed in the New York City tax base. It should be noted that, where the final formula percentage exceeds 66⅔%, it is reduced to that percentage, so that the maximum of the allocable receipts ever attributed to New York City is 66⅔%.

It was the application of this formula to petitioner's allocable (New York City interstate) receipts that resulted in attributing to this City approximately 45% to 48% of such receipts for the years in question. We have previ-

ously pointed out that, if a special formula had been devised to deal with the specific facts in the present case, it would have attributed a much higher percentage to New York City because there is no evidence which even suggests that any property or salaries and wages outside New York City contributed to creating these receipts aside from a portion of those of the executive office in Cincinnati and, possibly, a portion of those of Bloomingdale's Stamford, Connecticut store.

The formula meets the tests laid down by this Court in *Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942), where a statement was made with regard to California's net income tax law which is equally applicable to the formula under consideration (p. 506):

> "We read the statute as calling for a method of allocation which is 'fairly calculated' to assign to California that portion of the net income 'reasonably attributable' to the business done there."

(5)

The appellant's attack on the formula rests almost entirely on the argument that a formula which can result in taxing a higher percentage of the New York City interstate receipts when the taxpayer's receipts from sources outside the City increase must be an unreasonable and invalid formula. It hinges this argument on a theoretical and unrealistic assumption that the out-of-City receipts would increase while property and wages, both within and without the City, and all other receipts would remain unchanged. Even accepting this assumption, we shall show that the argument is unsound.

In the Court below the appellant illustrated the argument by asserting that an increase in sales by its Columbus, Ohio, store to residents of that city can

have no effect on sales by the New York City stores to New Jersey customers. Yet, under the formula if there were such an increase in Ohio sales and no other changes, there would be an increase in the percentage of the receipts from the New York to New Jersey sales which would be subjected to the tax. This, urged the appellant, established the unreasonableness of the formula.

An analysis of the purpose and nature of the formula, however, shows that it is entirely reasonable and proper for the portion of the New York City allocable receipts included in the tax base to increase under these limited circumstances. The appellant forgets that a portion of the property of the Ohio store and a portion of the wages of the Ohio store have been treated as contributing to the creation of the New York City allocable receipts. This is true of a portion of all property and all wages of the petitioner outside New York City. The size of the portion of such property and such wages attributed to creating the New York City allocable receipts depends upon the ratio between the allocable receipts and all of the other receipts of these out-of-City stores unrelated to and untaxed by New York City. When everything else remains stable but the Ohio receipts increase, the formula assumes that a greater proportion of the Ohio property and wages was used to create the Ohio receipts and a lesser proportion of the Ohio property and wages was devoted to creating the New York City allocable receipts.

The appellant, we are sure, would concede that, where there is an actual reduction in the out-of-City wages and property while the City property and wages remain the same, it would be proper for a formula to increase the share of New York City allocable receipts to be taxed by this City. The formula follows the same principle. It assumes that the portion of the Ohio store's property and wages helping create interstate receipts for the New York

stores has decreased when the Ohio store has increased its local Ohio sales. It assumes this decrease on the theory, entirely appropriate for a formula, that property and wages outside the City contribute to creating all receipts in similar proportions. Thus, assuming that all the property and wages of the petitioner outside New York City were the property and wages of the Ohio store, that the New York City allocable receipts were $1 million and that the total receipts of the Ohio store were $9 million, the formula would assume that one-tenth of the property and wages of the Ohio store were devoted to creating the New York City allocable receipts. If, without any increase in property or wages, the total receipts of the Ohio store for the following year increased to $19 million while the New York City allocable receipts remained $1 million, the formula would assume that only one-twentieth of the Ohio property and wages were devoted to creating the New York City allocable receipts. As a result, the New York City property and wages treated as creating the allocable receipts would become a larger proportion of the total property and wages treated as creating such receipts.

If property and wages in Ohio help create New York City allocable receipts and also help create Ohio receipts and it is impossible to determine the precise extent of their contribution to the creation of each type of receipts, it seems perfectly proper to attribute the Ohio property and wages to each type of receipt depending upon the percentage which it constitutes of the total of both types of receipts. In a year when the New York City allocable receipts is a larger proportion of both types of receipts, the share of the Ohio property and wages attributed to the New York City allocable receipts is greater. In a year when the New York City allocable receipts remain unchanged but the total of both types of receipts is increased because the Ohio sales have increased, the share of the

Ohio property and wages attributable to the New York City allocable receipts necessarily decreases.

Perhaps the appellant's failure to understand why this should be so stems from the fact that the formula is overgenerous to a taxpayer in the petitioner's circumstances. In fact, the property and wages of petitioner's store in Columbus, Ohio, do not contribute in any way to creating the New York City allocable receipts. Nevertheless, the formula, being designed for varied types of businesses, treats the Ohio store's property and wages as contributing to these allocable receipts. If, in accordance with the actualities, the formula disregarded the Ohio store's property and wages in determining how much of the New York City allocable receipts should be attributed to New York City, the share attributed to New York City would be far greater than it ever can be as long as some of the Ohio store's property and wages are treated as helping to create these allocable receipts.

The propriety of the formula may be best illustrated by a simplified example in which the formula does not, to the same extent as in the present case, unduly favor the taxpayer. Suppose a firm has a factory and a sales office in Ohio and has a sales office and a warehouse in New York City. In one year the factory manufactures goods to be sold for $10 million. It sells $8 million in Ohio. The remaining $2 million are delivered to and sold from the New York City warehouse. Of these latter sales $1 million are to New York City customers and the other $1 million are delivered to New Jersey customers.

It would seem clear that, where a formula must be used, it would be proper to treat one-tenth of the property and wages in Ohio as having helped create the $1 million of New York City allocable receipts since the $1 million is one-tenth of all the receipts produced as a result of the

factory's activities. In fact, the New York City formula attributes slightly more than this to Ohio. It uses a subfraction which places the $1 million of these allocable receipts in the numerator and the same $1 million plus the $8 million of Ohio receipts in the denominator. The resulting fraction is one-ninth or approximately 11%. It further favors the taxpayer by applying this 11% to, not only the property and wages of the Ohio factory, but also the property and wages of the Ohio sales outlet.

Now, let us suppose that the following year the property and wages of this firm do not change, but that its factory doubles its production. There are now $20 million worth of goods to be sold. New York City makes exactly the same sales as the year before, but Ohio increases its sales to $18 million. It would seem plain that a lesser share of the Ohio factory was devoted to producing the goods which resulted in the $1 million of New York City allocable sales. That $1 million of goods constituted only one-twentieth of the total of $20 million produced by the factory. Therefore, it is proper to treat only 5% of the Ohio factory's property and wages as having been devoted to producing the goods which resulted in the $1 million of allocable receipts. The New York City formula generously increases this to approximately 5.26% and applies this percentage to all of the Ohio property and wages.

Since the factors in the formula consist of a fraction which has as its numerator the New York City property helping to create the allocable receipts and has as its denominator all property helping to create these allocable receipts and a similar fraction for wages, the denominator in each of these fractions will be smaller for the second year since the Ohio property and wages attributed to the creation of the Ohio receipts is greater in the second year. The net result is that the final fractions show the New York City property and wages attributed to creating the

allocable receipts as a larger percentage of the total property and total wages treated as having created such allocable receipts.

It is this increase of percentage that results in New York City taxing a greater share of the allocable receipts in the second year. We can see no justification for the argument that such an increase is unfair and arbitrary. It seems entirely fair to assume that, when the same property and wages produce $10 million worth of goods in one year and $20 million in the next year, a smaller portion of the property and wages were used to produce the $1 million worth in the second year than in the first year.

Reduced to its simplest form, what we are attempting to say is this: If a man who is paid $20 a day produces two articles in a day, $10 of his pay should be attributed to each article. If he increases his efficiency without an increase in pay and later produces four articles in one day, only $5 of his pay should be attributed to each article.

Moreover, under the circumstances posed by the appellant the use of the Massachusetts three factor formula, as generally used for income taxes, would also result in an increase of the New York City tax. Accepting the appellant's assumptions, two of the factors—property and wages—would remain unchanged. The third factor, receipts, would decrease since a lesser percentage of the increased total would be New York City receipts. When the percentages for the three factors were added and divided by three, the final formula percentage attributable to New York City would still be decreased; but the decrease would be only one-third of the receipts' percentage decrease. This final formula percentage, however, would be applied to the entire net income, including all of the increase of income resulting from the increased Ohio receipts. The result would be an overall increase in the amount of the New York City tax.

(6)

At pages 21 to 22 of its jurisdictional statement, the appellant argues that the facts in the record refute an assumption underlying the formula. The assumption is that, as a general proposition, if wages and property remain unchanged and out-of-City receipts increase, there would be a decline in New York City receipts, both interstate and intrastate. The appellant points out that, although between 1953 and 1955 its percentage of wages and property outside the City remained substantially level and its out-of-City receipts increased both absolutely and relatively, the New York City interstate receipts increased also both absolutely and relatively. The relative increases, however, are so small as to be essentially meaningless. The out-of-City relative increase was less than 1% and City interstate receipts relative increase was 12/100 of 1%.

In addition, an examination of Respondent's Exhibit D (R. 303), from which appellant drew its figures and percentages, shows that the total of the New York City receipts did decline relatively. During this two-year period the out-of-City receipts increased approximately 14% while the New York City receipts, both interstate and intrastate, increased less than 10%. The fact that one portion of the New York City receipts, the interstate receipts, happened to increase at a greater rate, does not refute the basic assumption on which the formula rests. Increased interstate advertising or innumerable other factors may account for this increase in the interstate sales. The facts, however, accord with the assumption that, where property and wages are not increased, an increase in out-of-City sales is likely to result in a concomitant decrease in New York City sales.

(7)

The appellant's suggestion that the formula creates a risk of multiple taxation is completely without basis. The only receipts subjected to the tax are those from the purely local sales of the New York City stores plus, pursuant to the formula, an allocated portion of the interstate sales made by those stores. The receipts of the out-of-City stores are not touched by the tax. Thus, the tax base is less than the total of the receipts of the New York City stores. The states into which delivery is made by the City stores could not tax any portion of the receipts from such sales. New Jersey has no basis for such a tax since appellant has no store or office in that State. Nor is there any indication that Connecticut could tax such receipts. There is no evidence that the branch store in that State contributes in any way to bringing about the sales of the City stores to residents of Connecticut.

What has just been said also disposes of the contention, at pages 23 to 24 of the jurisdictional statement, that the appellant is "being taxed on business done outside the taxing jurisdiction."

(8)

The discrimination argument advanced at pages 18 to 20 of the jurisdictional statement is merely a variation of appellant's basic argument. There is no improper discrimination involved in applying a higher allocation percentage to the interstate sales made from the City by one taxpayer who has less out-of-City property and wages contributing to such sales than to another who, having the same amount and kind of sales, has more out-of-City property and wages contributing to those sales.

The formula reasonably assumes that, when the property and wages contributing to the creation of receipts

do not increase and, nevertheless, such receipts do increase, a smaller proportion of such property and wages is attributable to each dollar of such receipts. As a result, when the out-of-City receipts increase without any change in property and wages and without a change in other receipts, a smaller proportion of the out-of-City property and wages is attributed to each dollar of sales which it is assumed to have helped create. Since it is assumed to have helped create, in addition to the out-of-City receipts, the unchanged amount of New York City interstate receipts, the proportion of out-of-City property and wages deemed to have helped create these receipts becomes smaller. The net result is that the amount of New York City property and wages contributing to the creation of these interstate receipts remains unchanged while the amount of out-of-City wages and property contributing to such receipts is reduced. Consequently, the amount of New York City property and wages contributing to create these receipts becomes a higher percentage of the total property and wages contributing to the creation of the New York City interstate receipts.

Furthermore, as has been pointed out, the Massachusetts formula, recognized by the appellant as valid, would in its normal application have resulted in an increased City tax under the same circumstances.

(9)

The appellant repeatedly refers to the case of *General Motors Corp.* v. *District of Columbia*, 380 U.S. 553 (1965). In that case this Court refrained from passing on the constitutional issues, confining itself to a determination that the method of allocation was not authorized by the tax law. Moreover, the formula involved was a single sales factor formula under an income tax which attributed 100%

of the income to the District of Columbia on sales made into the District even though the products sold were manufactured and the orders were received outside the District and the products were shipped to the customers from points outside the District.

The appellant places great emphasis on the cases of *J. D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307 (1938); *Freeman* v. *Hewitt*, 329 U.S. 249 (1946), and *Indiana Department of State Revenue* v. *Nebeker*, 348 U.S. 933 (1955).

In the *Adams* case it was held that, even where a manufacturing corporation has its office, its factory and all other property in the taxing State, its gross receipts from interstate sales could not be subjected to a privilege tax without apportionment. Although the case did not discuss the nature of the required apportionment, the appellant concludes that it bars the use of the City formula. The theory is that, since the *Adams* case seems to hold that receipts from interstate sales must be apportioned even though the taxpayer has no property and possibly no payroll outside the taxing State, "it follows that it is not a proper function of an allocation formula to determine what portion of the taxpayer's out-of-State property or payroll contributed to the creation of receipts from interstate sales" (Juris. Statement, p. 17). It is submitted that this is precisely the function of an allocation formula, and that nothing in the *Adams* case opinion suggests the contrary. The appellant's theory would invalidate most, if not all, allocation formulas.

The City's formula meets the requirement of the *Adams* case that receipts from interstate sales must be apportioned even in a situation where there are no out-of-City property or wages. It does this by providing that no more than two-thirds of the allocable (*i.e.* interstate)

receipts shall be taxed. Under any formula it would be necessary to apportion on an arbitrary basis except under a formula with a receipts factor which treats receipts from out-of-State sales as not attributable to the taxing State. Assuming that a Massachusetts type three factor formula so treated the out-of-State sales, the formula would always result in allocating at least two-thirds of the receipts to the taxing State. Where all of the receipts came from outside of the State, the factor percentages would be as follows: Property, 100%; wages, 100%; and receipts, zero%. These percentages when added together and divided by three would result in 66⅔%. If some of the receipts came from or were treated as receipts of the taxing State, the precentage would be higher. This being so, the New York City formula, which automatically deducts one-third of the allocable receipts, is always as favorable to the taxpayer as the most favorable result under a Massachusetts type three factor formula under the circumstances of the *Adams* case.

It is difficult to believe that the *Adams* case can reasonably be construed to invalidate, not only the City formula, but also the Massachusetts formula.

The *Freeman* v. *Hewitt* case invalidated a gross receipts tax on an interstate sale of securities. The receipts upon which the tax was imposed were not apportioned. There is much dispute as to whether the determination was based on the failure to apportion or on the ground that a gross receipts tax may not be imposed on any of the receipts from an interstate sale.

The appellant seems to treat this case as though it were based on the same grounds as the *Adams* case. If this is so, our answer to the *Adams* case argument is equally applicable to this case. If, however, the appellant is citing the case for the proposition that none of the

receipts from an interstate sale may be subjected to a gross receipts tax, our answer is that apportioned gross receipts taxes on interstate sales and other activities are being treated by this Court as taxable. In the recent case of *General Motors* v. *Washington*, 377 U.S. 436 (1964), this Court said (p. 440):

> "Nevertheless, as we have seen, it is well established that taxation, measured by gross receipts is constitutionally proper if it is fairly apportioned."

To the same effect are: *Berkshire Fine Spinning Associates* v. *City of New York*, 5 NY 2d 347 (1959), dism. for want of a substantial fed. qn. 361 U.S. 3 (1959); *Central Greyhound Lines* v. *Mealey*, 334 U.S. 653 (1948).

The third case relied on by the appellant, the *Nebeker* case, differs from *Freeman* v. *Hewitt* only in that the securities sold were in a margin account. This Court, without opinion, affirmed on the authority of *Freeman* v. *Hewitt;* and, therefore, what has been said concerning *Freeman* v. *Hewitt* is equally applicable to this case.

(10)

The reference by the appellant to criticism of the City's formula by a Congressional committee does not relate to its constitutionality and, therefore, is irrelevant. It may be noted that the same committee leveled somewhat similar criticism at the Massachusetts type three factor formulas [Report of Special Subcommittee on State Taxation of Interstate Commerce, Volume 1 (Union Calendar No. 635, House Report No. 1480), pp. 194, 414-416].

CONCLUSION

The appeal to this Court from the judgment of the Court of Appeals of the State of New York should be dismissed, or the judgment affirmed.

November 18, 1966.

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